

This letter discusses taxation of sale/leaseback transactions. See 86 Ill. Adm. Code 130.2010. (This is a GIL).

December 2, 1999

Dear Xxxxx:

This letter is in response to your letter dated June 29, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

COMPANY requests an opinion regarding the taxable status of COMPANY's sales of computer systems to customers who subsequently enter into sale/leaseback arrangements for those systems with leasing companies.

Scenario

1. COMPANY's contract with the customer specifies that taxpayer will invoice the customer upon delivery of the computer system to the customer-designated site in your state, and that customer will pay taxpayer according to the terms of the invoice.
2. After contract acceptance but before delivery and invoicing, customer notifies COMPANY of their intent to enter into a lease agreement whereby customer will sell the ordered computer system to a leasing company and lease back the equipment back under an operating lease, not a financing lease. The computer equipment will remain in the customer's possession for use in its own data processing operations as an end user, and will not be placed into inventory for resale to other customers that would become end users.
3. COMPANY desires to deliver the computer system and invoice the customer in accordance with its contract. Before doing so, COMPANY obtains a certificate of resale exemption from customer. The certificate is completed in good form and signed by the customer. The certificate contains the note that the certificate is rendered pursuant to customer's intent to sell the equipment delivered under this contract to a leasing company for the purpose of leasing it back under an operating lease.
4. COMPANY then completes delivery and invoicing of the computer system to customer in your state. At the point of invoicing, the

customer has not yet entered into or finalized a sale/lease back agreement with a leasing company regarding the invoiced computer system.

5. COMPANY holds a sales and use tax registration for your state, and files returns monthly on an accrual basis.
6. The leasing company to which the equipment is subsequently sold by customer is registered for sales and use tax in your state and will offer customer a resale exemption certificate for its purchase of the equipment from customer. The leasing company will then invoice customer for sales tax on the monthly lease invoices.

With respect to the above scenario, several distinct situations may occur:

SITUATION 1: The customer has a sales and use tax registration for your state and is able to provide this registration number on the resale exemption certificate.

Question for Situation 1: Does COMPANY's acceptance of customer's resale exemption certificate relieve COMPANY from the obligation to invoice sales or use tax on the delivery of computer equipment it intends to sell to a leasing company and lease back under an operating lease?

SITUATION 2: The customer does not have a sales and use tax registration for your state, and therefore is not able to provide a registration number on the resale exemption certificate. The customer, as noted in Scenario (No. 6) above, will be making an exempt sale for resale to the leasing company in your state, based on receiving a properly completed resale exemption certificate from the leasing company for your state, indicating the leasing company's sales and use tax registration number for your state.

Questions for Situation 2: Is COMPANY relieved from the obligation to invoice sales or use tax on the delivery of computer equipment it intends to sell to a leasing company and lease back under an operating lease, if it accepts customer's resale exemption certificate for your state which does not show a sales and use tax registration for your state?

I appreciate your consideration in reviewing the above scenario COMPANY may encounter with its customers in your state. If you have any questions regarding the above situations and our related questions concerning them, I would be glad to discuss them with you.

For your information, we have enclosed a copy of 86 Ill. Adm. Code 130.2010, the Department's regulation that covers the taxation of leases. Under Illinois law, "true leases" and "leases" that are actually conditional sales contracts are treated differently for Retailers' Occupation and Use Tax purposes. Lessors are subjected to a Use Tax on their cost price or acquisition value of tangible personal property which they use by leasing in Illinois. The only exception is automobiles rented for one year or less.

True leases generally have no buy out provisions at the close of the leases. If buy out provisions do exist, they must be fair market value buy out options in order to maintain the character of the true leases. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See 86 Ill. Adm Code 130.220(a). As end users of tangible personal property located in Illinois, lessors incur Use Tax liability on their cost price of such property.

Under Section 130.2010(a), persons who purport to "lease" the use of property, but in fact sell such tangible personal property to nominal "lessees," are considered to be making conditional sales whose total receipts are subject to Retailers' Occupation Tax. Such would be the case when the agreements contain one dollar or other nominal purchase options.

Regarding sale/leaseback situations, typically customer A purchases equipment from retailer B, then sells it to lessor C who leases the equipment back to customer A. Customer A has paid tax when purchasing the equipment in the first transaction under a taxable retail sale and the second transaction (customer A's sale to lessor C) is a nontaxable occasional sale so long as A is not otherwise in the business of selling like-kind property. The third transaction (leaseback of the equipment from lessor C to customer A) is not taxable because, as noted above, Illinois does not impose a sales/use tax on rental receipts with the exception of automobiles rented for a period of one year or less.

In general, no special documentation is required for any of the transactions. In transaction 1 (sale from retailer B to customer A), retailer B would include the gross proceeds from its sale to customer A on its monthly sales tax returns and customer A would retain an invoice showing it paid tax to retailer B. In transaction 2 (sale from customer A to lessor C), it may be wise to document, on the invoice to lessor C, the fact that customer A is not otherwise in the business of selling like-kind equipment and that the sale is a nontaxable occasional sale. Transaction 3 (leaseback from lessor C to A) requires no documentation because rental receipts under true leases are not subject to Illinois sales tax liability (again, except automobiles rented for one year or less).

Sale/leaseback transactions are not generally used with conditional sales transactions because there is no statutory mechanism to provide a credit for tax previously paid by A. Ultimately if sale/leaseback transactions are used in conjunction with conditional sales, A will be liable for tax when the equipment is purchased and again when lessor C conditionally sells the equipment back to A.

What may be called "rental receipts" under the transaction are considered deferred payments. To avoid this result, A would need to lease the equipment from C under a true lease rather than a conditional sale.

In the event customer A is in the business of selling the kind of tangible personal property it purchases for resale to lessor C, customer A could give a properly executed resale certificate to retailer B when it purchases the tangible personal property for resale to lessor C. See 86 Ill. Adm. Code 130.1405, copy enclosed. If lessor C is also in the business of selling the kind of tangible personal property it purchases from customer A, it could give customer A a resale certificate when it purchases the tangible personal property from customer A, but only if it will sell the tangible personal property back to customer A under a conditional sale rather than use the tangible personal property as the lessor under a true lease. If lessor C will lease the tangible personal property to customer A under a true lease, lessor C will be the user of the tangible personal property and will owe Use Tax.

Resale numbers are issued to persons who make no taxable sales in Illinois but who need the wherewithal to provide suppliers with resale certificates when purchasing items that will be resold. So long as such retailers do not act as Illinois retailers and do not fall under the definition of a "retailer maintaining a place of business in this State," (see 86 Ill. Adm. Code 150.201(I), copy enclosed, and the U.S. Supreme Court case of Quill Corp. v. North Dakota, 112 S.Ct. 1904 (1992)) their sales to Illinois customers are not subject to Illinois Retailers' Occupation Tax liability and they cannot be required to act as a Use Tax collector. So long as this is true, such retailers qualify for a resale number that does not require the filing of tax returns with the Illinois Department of Revenue.

Please note that while active registration or resale numbers on resale certificates are preferred, Section 2c of the Retailers' Occupation Tax Act (35 ILCS 120/2c) provides that "[f]ailure to present an active registration number or resale number and a certification to the seller that a sale is for resale creates a presumption that a sale is not for resale. This presumption may be rebutted by other evidence that all of the seller's sales are sales for resale, or that a particular sale is a sale for resale."

The transactions described in your letter are confusing. However, it is our understanding that you have described transactions in which suppliers ("supplier") will sell equipment to customers ("Customer A"), who then resell the equipment to lessors ("lessor"). Lessor will then lease the equipment to Customer A under a true lease.

If Customer A has a resale or registration number, then it may provide a resale certificate to its supplier when it purchases the equipment that it will resell to the lessor for use under a true lease. Customer A will incur Retailers' Occupation Tax on the sale to the lessor. There is no tax on the rental receipts if the lease is a true lease.

If, on the other hand, Customer A cannot provide a resale certificate to its supplier, it must pay tax when it purchases the equipment. So long as Customer A is not in the business of selling like kind equipment, then Customer A's sale of the equipment to the lessor is an "occasional sale" not subject to tax. See 86 Ill. Adm. Code 130.110, copy enclosed. Under a true lease, no tax is due on the rental receipts.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Martha P. Mote
Associate Counsel

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Enc.